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C O N F I D E N T I A L SECTION 01 OF 02 AMMAN 002050

SIPDIS

TREASURY FOR GLASER/ZARATE

E.O. 12958: DECL: 01/24/2015
TAGS: EFIN ECON PGOV JO
SUBJECT: A STEP FORWARD AND A SHUFFLING OF FEET: BANKING SECTOR CONSOLIDATION CONTINUES ITS ERRATIC PATH

REF: A. AMMAN 538

¶B. 2004 AMMAN 8133
¶C. AMMAN 2044

Classified By: Charge d'Affaires David Hale for reason 1.4 (b) and (d)

¶1. (C) SUMMARY: The excellent recent profitability of banks is continuing to drive change in the Jordanian banking sector. A successful medium-sized bank is looking for a partner in what would be the first merger not driven by a bank failure in well over a decade and the last remnants of the 2002 Shemaileh scandal may have been tidied up as part of a previously reported merger between JNB and PIB. While indicative of the sector,s current vibrancy, however, these deals are only the beginning of the consolidation that the Central Bank of Jordan wishes to see. And each deal has features that indicate actual or potential problems in the sector. END SUMMARY.

CONSOLIDATION...

¶2. (C) Jordan Kuwait Bank (JKB), whose profitability in 2004 was the highest in the banking sector, has been looking hard for a potential acquisition. It is currently zeroing in on a merger with the substantially smaller Jordan Investment and Finance Bank (JIFB). The acquisition would give Jordan Kuwait Bank a stronger investment banking wing and position it to capitalize on the substantial IPO-related business that appears likely over the upcoming year (septel). If JKB is indeed able to acquire JIFB, it will be the first merger between solvent banks in over a decade - a victory for the CBJ's centralization strategy.

¶3. (C) JKB's interest in JIFB, however, comes primarily as a result of the disappointment of its earlier hopes to acquire Cairo-Amman Bank (CAB). CAB is controlled by Sabih and Munib al-Masri and their family interests - also major investors in Jordan's tourism sector and in Palestinian Telecommunications Co. (PALTEL) and Palestinian Development and Investment Co. (PADICO) - and is approximately the same size in terms of assets (though not in terms of profits) as is JKB. Its much more extensive branch network, however, dovetails nicely with JKB's long-term goals in focusing on retail operation. JKB had been in talks with the al-Masri family to purchase that family's stake as part of a larger buyout of the bank. The Masris, in turn, had been quietly increasing the size of their stake in the much larger Arab Bank. All told, the Masri holdings now amount to approximately 13% of Arab Bank's equity (vs. 11% for the Shoman family, the Arab Bank's founders and managers for three generations, and 14% for the Hariri family, the largest individual shareholders). Market speculation held that the Masri sellout from CAB was intended to provide the family with the capital to substantially increase its stake in Arab Bank. After leaks reporting an impending OCC action against Arab Bank's New York City branch, however, the al-Masri family appears to have reconsidered its strategy and will not be exiting CAB for the foreseeable future.

...AND A COVER-UP?

¶4. (C) Meanwhile, the terms of the recently-announced Jordan National Bank (JNB) acquisition of Philadelphia Investment Bank (PIB) (ref A) are becoming more clear. JNB, which incurred serious losses in the 2002 Shemaileh banking scandal, appears to have agreed to acquire PIB, which was bankrupted by the Shemaileh scandal, as part of a CBJ wind-up of the last remains of the scandal (ref B). JNB will absorb PIB, whose portfolio is almost entirely composed of liabilities and nonperforming loans (NPLs); in return, the CBJ will cover PIB's liabilities, put pressure on some of the solvent NPL holders (such as Khalid Shahin - septel) to pay their debts, and deposit JD 150 million ($211.5 million) in a non-interest-bearing account in JNB. One JNB source claims that the generous terms offered by the CBJ stem from the CBJ's desire to avoid drawing publicity to some of the events

surrounding the Shemaileh scandal itself. According to the source, even after the CBJ discovered what was going on, its fear of the General Intelligence Directorate (whose former chief was eventually implicated in the scandal and is now under house arrest) led it to move very carefully. The CBJ did not notify the private banks of its findings until it felt it had sufficient political cover to do so - after JNB had transferred tens of millions of dollars to al-Shemaileh in the belief that the transactions were legitimate and secured.

CBJ LOOKS DOWN THE ROAD

¶5. (C) The CBJ requirement that banks increase their paid-up capital to JD 40 million ($56.4 million) by the beginning of 2006 has not produced significant consolidation; in the current bull market on banking stocks, most Jordanian banks have found it easy to increase their paid-up capital to the required amounts by simply issuing more stock. The CBJ has not yet given up on this strategy, however; in recent public announcements, the CBJ Governor has put banks on notice that the CBJ will require that Jordanian banks have paid-up capital of JD 100 million ($141 million) by 2010.

COMMENT

¶6. (C) 2004's windfall profits are driving change in the banking sector, both by creating new pools of capital for particularly successful banks to look to acquire others and by stimulating outside interest in the sector. A merger involving JKB would be the first in memory to occur without significant CBJ prodding - a good sign for the health and maturity of the banking sector. The apparent reluctance of the Masris to get more deeply involved in Arab Bank, however, is not a good sign for that bank. For a family with such unabashed zeal for Palestinian institution-building as the Masris to pass up the chance to acquire a controlling interest in the largest and most respected Palestinian business in the world, they must be deeply uncomfortable with the potential for action against the bank - and the family's reported discomfort is already beginning to unsettle market insiders. Despite the market rumors of Saad al-Hariri's enthusiasm for Arab Bank's prospects, there is some concern that the Hariri family could move to dump some or all of its interest in the Bank if ongoing events in Lebanon led the Hariris to need more liquidity; if the Masris are not ready to take such shares off the Hariris' hands, it is difficult to imagine who would.

¶7. (C) The CBJ also appears vulnerable in its role in sweetening the JNB-PIB merger. If the JNB source is correct, the CBJ is involved in what amounts at best to a mild cover-up of its role in the Shemaileh scandal. Even if the JNB source is incorrect, the CBJ action is a joint bailout of two banks that made bad decisions - at least one of which will face no further negative consequences. Parliament has already noticed this trend and spoken out against it: one of the Chamber of Deputies, recommendations on the 2005 budget was that the GOJ not "suffer any financial burden" related to mergers between banks (Ref D). A JD 150 million ($211.5 million) non-interest bearing deposit would seem to be a significant burden in terms of forsaken revenue for the GOJ - and the GOJ will hold its breath and hope that Parliament does not discover or understand this fact.
HALE